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No._____

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IN THE

Supreme Court of the United States

October Term, 1983

THE PEOPLE OF THE STATE OF CALIFORNIA AND THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA,

Appellants,

vs.

UNITED STATES OF AMERICA, AMERICAN TELEPHONE AND TELEGRAPH COMPANY, *et al.*,

Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF COLUMBIA

JURISDICTIONAL STATEMENT

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Questions Presented

1. Whether the District Court violated the provisions or principles of the Modification of Final Judgment ("MFJ") or abused its discretion in approving the plan of reorganization ("POR") without requiring that assets of the Bell Operating Companies ("BOCs") in Account 232 relating to station handling and/or complex intrasystem wiring be assigned to American Telephone and Telegraph Company ("AT&T") as constituting, or as "relating to the provision of," customer premises equipment ("CPE").

2. Whether the District Court violated the provisions or principles of the MFJ or abused its discretion in approving the POR without requiring that the average cost of the long-term funded debt retained by The Pacific Telephone and Telegraph Company ("Pacific") at the time of the divestiture be representative of the average cost of such consolidated debt held by AT&T, its affiliates and the BOCs.

Parties Below

In addition to the United States, AT&T, Western Electric Company, Inc. and Bell Laboratories, Inc., the following parties were admitted as intervenors in the District Court: *Ad Hoc* Telecommunications Users Committee; American Newspaper Publishers Association; American Petroleum Institute; American Satellite Company; Associated Telephone Answering Exchanges, Inc.; Association of American Railroads; Association of Data Communications Users; Association of Data Processing Service Organizations; Audichron Company; Black Citizens for a Fair Media; California Hispanics; Citizens Utilities Company; Communication Commission of the National Council of the Churches of Christ in the USA; Communications Workers of America; Compuserve, Inc.; Computer and Business Equipment Manufacturers Association; Computer and Communications Industry Association; Congress Watch; Continental Telecom, Inc.; D/FW Signal, Inc.; Education and Cultivation Division of the General Board of Global Ministries of the United Methodist Church; Federal Communications Commission; General Dynamics Communications Co.; General Telephone & Electronics Corp.; Independent Data Communications Manufacturers Association; Independent Telecommunications Suppliers' Council; International Telephone and Telegraph Corp.; Jack Faucett Associates, Inc., *et al.*; Leghorn Telepublishing Co.; MCI Communications Corp.; Mobile Marine Radio, Inc.; National Association for the Advancement of Colored People; National Association for Better Broadcasting; National Association of Broadcasters; National Association of Regulatory Utility Commissioners; National Association of State Utility Consumer Advocates; National Cable Television Association; National Catholic Broadcasters Association; National Citizens Committee for Broadcasting; National Latino Media Coalition; National Newspaper Association; North American Telephone Association; Northeastern

Telephone Co.; Office of Communication of the United Church of Christ; Reformed Church in America; Rogers Radio Communication Services, Inc.; Rural Telephone Coalition; San/Bar Corp.; Satellite Business Systems; Sonitrol Distributors Council, Inc.; Southern Pacific Communications Company; Sperry Corporation; Stromberg-Carlson Corp.; Tandy Corporation; Telocator Network of America; U.S. Telephone Communications, Inc.; United States Independent Telephone Association; United States Telecommunications Suppliers Association; United Telecommunications, Inc.; Utilities Telecommunications Council; Warner Amex Cable Communications, Inc.; Western Union Telegraph Co.; Westinghouse Broadcasting and Cable, Inc.; Alarm Industry Telecommunications Committee; States of Arizona, California, Colorado, Delaware, Illinois, Maine, Maryland, Michigan, Missouri, New Hampshire, New Mexico, New York, North Carolina, Oregon, Pennsylvania, Tennessee, Virginia, Wisconsin; Alabama Public Service Commission; Arkansas Public Service Commission; California Public Utilities Commission; District of Columbia Public Service Commission; Florida Public Service Commission; Idaho Public Utilities Commission; Kentucky Public Commission; Michigan Public Service Commission; Missouri Public Service Commission; Montana Public Service Commission; Nebraska Service Utilities Commission; Nevada Public Service Commission; New York Public Service Commission; South Dakota Public Utilities Commission; Utah Public Service Commission; Public Service Commission of West Virginia; Wisconsin Public Service Commission; Wyoming Public Service Commission; Iowa Commerce Commission; Kansas Corporation Commission; New Mexico Corporation Commission; Ohio Consumers Counsel; Oklahoma Corporation Commission; Virginia State Corporation Commission; Washington Utilities & Transportation Commission; City of Cincinnati; City of New York. (Appendix to Jurisdictional Statement (App.) at 191-194.)

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UNITED STATES OF AMERICA, AMERICAN TELEPHONE AND TELEGRAPH COMPANY, *et al.*,

Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF COLUMBIA

JURISDICTIONAL STATEMENT

Appellants, the People of the State of California and the Public Utilities Commission of the State of California ("CPUC"), respectfully request that the Court note probable jurisdiction of their appeal from the District Court's memorandum and order of August 5, 1983, approving American Telephone and Telegraph

Company's ("AT&T's") proposed plan of reorganization ("POR"), as amended by AT&T and as further modified by the District Court's opinion of July 8, 1983, and memorandum of July 28, 1983. The appeal has been certified to this Court by the District Court pursuant to the Expediting Act, 15 U.S.C. §29(b).

Opinions Below

The opinion of the District Court filed August 11, 1982 (App. at 1-172), and the Modification of Final Judgment ("MFJ") filed August 24, 1982 (App. at 173-190), are officially reported as *United States v. AT&T*, 552 F. Supp. 131 (D.D.C. 1982), *aff'd. mem. sub nom. Maryland v. United States*, ____U.S.____, 75 L. Ed. 2d 472, 103 S. Ct. 1240 (1983).

The District Court's opinion of July 8, 1983 (App. at 195-330), not yet officially reported, is published at Trade Reg. Rep. (CCH), Rpt. No. 604 (extra ed. July 19, 1983). The District Court's memorandum of July 28, 1983 (App. at 331-340) is neither officially nor unofficially reported. The District Court's memorandum and order of August 5, 1983 (App. at 341-350), not yet officially reported, are published at 1983-2 Trade Cas. (CCH) ¶65,536. The District Court's order of September 7, 1983 (App. at 351-354), not yet officially reported, is published at 1983-2 Trade Cas. (CCH) ¶65,596.

Jurisdiction

In this civil antitrust suit brought by the United States against AT&T and its affiliates under the Sherman Act, 15 U.S.C. §§1-4,[1] the District Court's MFJ filed August 24, 1982, has been affirmed by this Court. (*United States v. AT&T*, 552 F. Supp. 131, 226-234 (D.D.C. 1982), *aff'd. mem. sub nom. Maryland v. United States*, ___U.S.___, 75 L. Ed. 2d 472, 103 S. Ct. 1240 (1983).)

After AT&T's submission of its proposed POR as required by the MFJ, the District Court held public comment proceedings in accordance with the Tunney Act, 15 U.S.C. §16, in order to ascertain whether the POR was consistent with the MFJ as well as the public interest. In ruling on the comments submitted by appellants and others, the District Court rejected appellants' claims raised herein and, by its order of August 5, 1983, approved the POR, as amended by AT&T and as further modified by the District Court's rulings of July 8, 1983, and July 28, 1983. The District Court's order of August 5, 1983, approving the POR, is a final order for purposes of appeal.[2]

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[1] The complaint in the primary suit engendering this appeal, *United States v. Western Electric Company, Inc.* (Civil Action No. 82-0192 (D.D.C.), formerly Civil Action No. 17-49 (D.N.J.)), alleged violation of 15 U.S.C. §§1-3. The complaint in *United States v. American Telephone and Telegraph Company* (Civil Action No. 74-1698 (D.D.C.)) alleged violations of 15 U.S.C. §2. Federal jurisdiction in both cases rests on 15 U.S.C. §4 and 28 U.S.C. §1337.

[2] *See Brown Shoe Co. v. United States*, 370 U.S. 294, 310 n.16 (1962), and cases there cited.

On August 10, 1983, appellants filed a timely notice of appeal,[3] and on September 7, 1983, the District Court filed an order granting the motion of the Department of Justice for certification of this and any subsequent appeals directly to this Court pursuant to the Expediting Act, 15 U.S.C. §29(b).

Federal appellate jurisdiction is predicated on 28 U.S.C §§1291 and 2107. (*See* 15 U.S.C. §29(a).) Jurisdiction for direct appeal to this Court is conferred by 15 U.S.C. §29(b).

Statutory Provisions

The text of 15 U.S.C. §§16 and 29 is set forth in the Appendix. (App. at 359-364.)

Statement of the Case

On February 28, 1983, this Court affirmed the MFJ.[4] (*Maryland v. United States*, ____U.S.____, 75 L. Ed. 2d 472, 103 S. Ct. 1240 (1983).)

The MFJ (also referred to as "the decree") requires the retention by AT&T of "all facilities, personnel and books of account . . . relating to . . . the provision of customer premises equipment to the public." (MFJ, §§I(A)(2), I(A)(4); App. at 174-175.) The decree defines CPE as "equipment employed on the premises of a person (other than a carrier) to originate, route, or terminate telecommunications," not including "equipment used to multiplex, maintain, or terminate access lines." (MFJ, §IV(E); App. at 177.)

[3] The District Court's order of August 26, 1982, admitted appellants as intervenors below (App. at 191-194) and expressly conferred on appellants the right to appeal the District Court's decision concerning the POR (App. at 194).

[4] For a history of this litigation prior to the District Court's approval of the MFJ, *see* App. at 3-25.

The MFJ also provides that, at the time of reorganization, "the quality of the debt [of the separated BOCs] shall be representative of the average terms and conditions of the consolidated debt held by AT&T, its affiliates and the BOCs at that time." (MFJ, §VIII(H); App. at 184-185.)

In declaring its conditional approval of the decree, the District Court addressed the concern "that AT&T might manipulate the actual division of assets and liabilities to the detriment of the Operating Companies." (App. at 133.) It concluded that there were safeguards to protect against such abuse by AT&T, including *inter alia* the following: (1) the decree's requirement that assets be divided according to function or, where an asset serves functions relating to services to be rendered by both AT&T and the BOCs, according to its predominant use (App. at 134-136); (2) the requirement that AT&T leave with each BOC debt issues reflecting terms and conditions comparable to those of the consolidated debt held by the Bell System as a whole (App. at 136-137); and (3) the requirement that the POR not be implemented until its approval by the District Court as being consistent with the provisions and principles of the decree (App. at 156) as well as the public interest (App. at 159).

However, AT&T's plan of reorganization stated that the entire Account 232, which in large part records investments in (1) station handling, the labor costs incurred in the transportation, installation and delivery of customer premises equipment such as telephones, private branch exchanges ("PBXs") and key telephone equipment, and (2) complex intrasystem wiring used to connect on-premises business-type telecommunications apparatus and material and labor costs incurred in the

installation of such inside wiring, "does not contain customer premises equipment and, therefore, will remain with the BOCs" (POR, §I(A)(2)(a)(v), at 86). In addition, despite the MFJ's requirement that "the quality of the debt [of the separated BOCs] shall be representative of the average terms and conditions of the consolidated debt held by AT&T, its affiliates and the BOCs" (MFJ, §VIII(H); App. at 184-185), the POR proposed that the cost of funded debt for each of the divested BOCs would be approximately the same, *except for Pacific Telephone*, which would be left with a substantially higher average cost of funded debt than the other six regional BOCs and the Bell System as a whole (POR, §I(B)(4), at 193-195).

Appellants vigorously opposed these provisions of the POR in their initial comments submitted to the District Court, contending that the MFJ and the public interest required (1) that the portion of Account 232 pertaining to complex intrasystem wiring and station handling costs be assigned to AT&T rather than the BOCs,[5] and (2) that Pacific, like the other BOCs, be left with a cost of funded debt in line with the average cost of debt of the Bell System as a whole. (Prelim. Comments, CPUC, at 23-31; Further Comments, CPUC, at 12-25, 46-48.) AT&T and the Department of Justice filed written opposition to these claims (AT&T Response, at 149-169, 276-305; DOJ Response, at 84-91, 117-122), and appellants replied (Reply Comments, CPUC, at 7-13, 16-26).

[5] While appellants raised the station handling issue in a general manner by including it in their Account 232 complex intrasystem wire discussion and numerical estimates in the court below (*see* note 7, *infra*), the New York Department of Public Service and other parties raised it as a separate issue. (Comments, N.Y. Dept. Pub. Serv. at 10-11; Comments, Computer and Business Equipment Manufacturers Association, at 16-17; Reply Comments, Independent Data Communications Manufacturers Association, at 31-33.)

The District Court's decision filed July 8, 1983, conditionally approving the POR (App. at 197), purports to reject appellants' cost-of-debt claim in a footnote (App. at 221-222 n.64) and fails to address the complex intrasystem wiring and station handling claims. The District Court's memorandum of July 28, 1983, requiring further modification of the POR, makes passing reference to the inside wiring claim, again in a footnote. (App. at 339 n.18.) The District Court's memorandum filed August 5, 1983, approving the POR, refers briefly to the general inside wiring and station handling claims but fails to address specifically the complex intrasystem wiring claim. (App. at 343-344.)

On August 10, 1983, appellants filed their notice of appeal herein (App. at 355-356).

On August 25, 1983, without appellants' support or participation, the Department of Justice moved for certification of this and any subsequently filed appeals directly to this Court pursuant to 15 U.S.C. §29(b). (*See* App. at 351-352.) On August 26, 1983, AT&T filed a response in support of the motion (*see* App. at 352), and on September 7, 1983, the District Court granted the motion (App. at 354).

This appeal follows.

The Questions are Substantial

I. Introduction

This appeal does not seek to halt the AT&T divestiture, presently scheduled to occur on January 1, 1984. No stay has been sought nor is one desired.

Instead, should appellants prevail on the merits of their claims, appropriate relief would consist of this Court's ordering the District Court, in accordance with that court's continuing jurisdiction to enforce the MFJ, to take all steps necessary to ensure (1) that station handling and complex intrasystem wiring costs reflected in Account 232 be assigned to AT&T, rather than the BOCs, and (2) that the Pacific Regional BOC be left with a portfolio of long-term debt with an average cost of debt in line with that of AT&T, its affiliates and the BOCs at the time of divestiture.[6]

The financial stakes in this appeal are staggering. It is estimated that the complex inside wiring claim alone involves net investment of approximately $3 billion nationwide and $332 million[7] for Pacific Telephone, appellants' regional BOC. It is further estimated that the station handling claim alone involves a net investment of roughly $2.3 billion nationwide and a net investment for Pacific Telephone as of December 31, 1982, of approximately $260 million.[8] The assignment of station

[6] Such relief can presumably be accomplished by the District Court's ordering or voiding conveyances, ordering reconveyances or ordering the payment of money, where appropriate.

[7] Appellants in their comments below used the figure $474 million to describe net investment for the complex inside wiring subaccount for Pacific Telephone. This included approximately $142 million of station handling costs for complex telecommunications systems.

[8] Pacific Telephone's accounting system, for one, permits disaggregation of Account 232 by telephone product group information. (*See* Pacific Telephone Vertical Embedded Analysis Reporting System.)

handling and intrasystem wiring to AT&T, rather than to the BOCs, would reduce BOC rate bases by those amounts. It would thus mean at least a $1.5 billion reduction in 1984 BOC revenue requirements nationally and a corresponding $240 million reduction in Pacific's 1984 revenue needs—reductions which would significantly mitigate anticipated increases in basic monthly rates.

Such figures, though enormous, should not be surprising. After all, this case involves what the District Court has termed "the largest corporate reorganization in history." (App. at 353.)

Appellants' claims raise the serious potential that AT&T's plan of reorganization effects a distribution of assets contrary to the provisions and principles of the decree as well as the public interest.[9] If, as appellants contend, AT&T's POR improperly grants AT&T undue competitive advantage in its newly deregulated markets at the expense of the BOCs and, ultimately, the ratepaying public who must bear the cost of the BOCs' disadvantage, such a result must not go unredressed. But that determination can only properly be made after the issues have been clearly focused by full briefing on the merits and oral argument.

With little or no analysis, the District Court has rejected appellants' claims, which involve billions of dollars and affect millions of people. The only meaningful check on the District Court's action is effective review by at least one appellate tribunal. In light of the

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[9] It is notable that both AT&T and the Department of Justice resisted the District Court's attempt to subject the POR, or implementation, phase of the proceedings below to the public interest review authorized by the Tunney Act, 15 U.S.C. §16 (App. at 359-363). The District Court forcefully rejected such arguments (App. at 149-156).

enormous stakes involved in this case and the serious possibility that the public interest has been compromised, appellants' claims warrant this Court's close scrutiny and its plenary consideration.

II. Account 232

The FCC's Uniform System of Accounts for Telephone Companies provides for an asset account referred to as Account 232 which reflects investment in a variety of functions related to the bringing of telecommunications services onto the customer's premises. (*See generally Amendment of Uniform System of Accounts*, 85 F.C.C. 2d 818, 823-828 (1981).)[10] Consolidated investment reflected in AT&T's Account 232, amounting to approximately $15 billion,[11] includes *inter alia* the following elements: (1) *station handling*, or labor costs incurred in the delivery and installation of telephones, certain types of private branch exchanges ("PBXs") and key system apparatus on the premises of residential and business customers, and (2) *complex intrasystem wiring*, or material and labor costs incurred in the installation of wiring on the business customer's premises which connects the PBX, key telephone equipment, telephone

[10] In the past, Account 232 assets have not been recovered from the customer by up-front charges at the time of installation of a telecommunications system but instead have been capitalized. This capitalization policy allowed a customer to be connected to the phone system at minimal cost, a policy that enabled AT&T to greatly expand its customer base. Two years ago the FCC, sensitive to competitive concerns in the CPE market raised by AT&T and other vendors, ordered that all future inside wiring and station handling costs be expensed and charged to the cost-causitive customer. The previously capitalized costs were ordered to be recovered over a ten-year period with a prescribed amortization schedule. (*Amendment of Uniform System of Accounts, supra*, 85 F.C.C.2d at 823-828.)

[11] *See* Form 10K, Annual Rpt. of AT&T to SEC—Fiscal 1981, at 22.

instruments, and other components together to form the customer's telecommunications system.[12]

The MFJ provides that AT&T retain "all facilities, personnel and books of account ... relating to ... the provision of customer premises equipment to the public." (MFJ, §§I(A)(2), I(A)(4); App. at 174-175.) The decree defines CPE as "equipment employed on the premises of a person (other than a carrier) to originate, route, or terminate telecommunications." (MFJ, §IV(E); App. at 177.)

Consistent with these provisions, AT&T's plan of reorganization deems all PBXs, key system apparatus and telephone instruments to be CPE and assigns them to AT&T. (POR, §I(A)(2), at 78-82.) However, the POR goes on to assign the entirety of Account 232, including station handling and complex intrasystem wiring costs, to the BOCs. (POR, §I(A)(2)(a)(v), at 86.)

Appellants contend that the assignment of the station handling and complex intrasystem wiring costs reflected in Account 232 to the BOCs, rather than to AT&T, violates the provisions and principles of the MFJ as well as the public interest. Appellants request that this Court modify the POR to secure its compliance with the MFJ or order the District Court to do so.

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[12] Account 232 also includes investment in the installation of (1) simple inside wiring for residential and small business telephones and related installation costs and (2) drop and block wire, associated protectors and related installation costs.

For purposes of this appeal, it is important to distinguish between the two types of inside wiring, each of which is designated by the nature of the customer premises installation, *i.e.*, *simple* wiring and *complex intrasystem* wiring. The former is typically found in a residential setting, between the protector block near the outside of the residence and the jack to which the home telephone instrument is connected. The latter, typically found in business installations, connects the PBX, key telephone equipment, telephone instruments, and other components together to form the customer's complex on-premises telecommunications system.

A. Station Handling

By assigning the $2.3 billion in station handling costs reflected in Account 232 to the BOCs, the POR enables AT&T to obtain already-installed telephones, PBXs and key system apparatus at a cost which covers only the equipment and to impose on the BOCs the costs actually incurred in the delivery, installation and testing of that equipment.[13] The arrangement flatly violates the decree's requirement that AT&T retain all "books of account ... *relating to ... the provision of* customer premises equipment to the public." (App. at 174-175.) It contravenes generally accepted accounting principles which include the costs of delivery and installation in the cost of the machinery installed. (Reply Comments, CPUC, at 21-22.) It also violates the decree's principle that assets are to be divided according to function (App. at 134-6); station handling has everything to do with AT&T's CPE functions and nothing to do with the BOC's exchange telecommunications and exchange access functions.

Indeed, AT&T acknowledges that conceptually station handling investments may be considered CPE but argues that its inability to separate out the different elements of Account 232 renders its retention of such assets impracticable. (AT&T Response, at 154-155.) The Department of Justice supinely accepts this claim. (DOJ Response, at 91 n.*.) The District Court also accepts AT&T's argument, while recognizing that "a theoretical

[13] A portion of station handling costs relates to installation of CPE which will, at divestiture, have been sold to BOC customers pursuant to sales programs authorized by state regulatory agencies. Inasmuch as these CPE assets will not be assigned to AT&T, appellants propose that this portion of station handling costs also not be assigned to AT&T.

case could be made that, since under the plan embedded CPE is being assigned to AT&T, so should this portion of Account 232." (App. at 344.)

However, in reaching its conclusion the District Court completely ignores the comments of New York[14] and California,[15] which together regulate approximately 20 percent of the pre-divestiture Bell System, to the effect that the BOCs in California and New York had already separated out the various elements of Account 232 and that other states would not find it difficult to do the same. What makes AT&T's position particularly unconscionable is that AT&T was undoubtedly aware that its two largest operating company subsidiaries had broken out the elements of Account 232 when it asserted that this was impossible. Even more troubling is why the Department of Justice and the District Court, faced with the comments of California and New York, never even questioned AT&T on this important factual dispute between the company and the regulatory agencies of the two largest states.

AT&T surmises that the BOCs will be allowed by state regulatory agencies to recover this multi-billion dollar investment by increasing local telephone rates charged to ratepayers who may not be customers of AT&T's CPE operations.[16] Such a scenario is neither fair to the ratepaying public nor consistent with the MFJ.

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[14] Comments, N.Y. Dept. Pub. Serv., at 11.

[15] Further Comments, CPUC, at 24; Reply Comments, CPUC, at 26.

[16] Affidavit of Zane F. Barnes, President of Southwestern Bell Telephone Company, December 13, 1982, pgs. 3-4. Affidavit of Wallace R. Bann, designated Chief Executive Officer of the Southwest Regional Holding Company, dated December 14, 1982, at 2-3.) Supplemental Statement of Donald E. Guinn, Chairman of the Board and Chief Executive Officer of Pacific Telephone dated January 13, 1983, at 3.

B. Complex Intrasystem Wiring

PBXs and key telephone equipment are essentially "switchboards" that route calls once they have entered a customer's place of business. Complex intrasystem wiring connects a PBX or key system machine, telephone instruments, and other components to form a complex telecommunications system on the customer's premises.

As above noted, AT&T has assigned to itself substantially all PBXs, key system machines and telephone instruments as CPE. (POR, §I(A)(2), at 78-82.) Nevertheless, it has assigned all complex intrasystem wiring, which joins the components of a customer's complex business CPE system, to the BOCs. (POR, §I(A)(2)(a)(v), at 86.)

The assignment of complex intrasystem wiring to the BOCs flatly violates the provisions and principles of the MFJ. First, the definition of CPE contained in the MFJ clearly embraces complex inside wiring. That definition is "equipment employed on the premises of a person . . . to . . . route . . . telecommunications." (MFJ, §IV(E); App. at 177.)

Second, even if such inside wiring were not deemed CPE, it most certainly constitutes "facilities, personnel, and books of account . . . *relating to* . . . *the provision of* customer premises equipment to the public." (MFJ, §I(A)(2); App. at 174-175.)

In the past, CPUC has recognized the integrated nature of complex on-premises telecommunications systems by including an intrasystem wiring charge in most Pacific Telephone tariffs for PBX and key system apparatus. Such wiring charges recover a substantial portion of the annual carrying costs of Pacific's

investment in complex intrasystem wiring. When complex CPE systems are transferred to AT&T upon divestiture it is only logical that the entire group of assets be kept as a unit. (*See* Kieso & Weygandt, Intermediate Accounting (1974), at 437.) Failure to do so will permit AT&T either to reap excessive profits by maintaining CPE rental charges at their present levels, or to undercut its competitors by reducing such charges to reflect the fact that it no longer need recover investments in complex intrasystem wiring.

AT&T's assignment of such wiring to the BOCs is unfair to local ratepayers and imposes an unreasonable burden on the BOCs. As noted above, investment in complex intrasystem wiring is now being recovered in part through equipment rates to business customers. If business customers are to continue to pay for this wiring, it should be transferred to AT&T, with the expectation that AT&T will charge those customers for the wiring as part of the complex CPE rate.

Beyond these considerations, assigning assets related to complex intrasystem wiring and associated installation costs to the BOCs, rather than to AT&T, violates the MFJ's central principle that assets be divided according to function. (App. at 134-136.) The function of complex intrasystem wiring is inextricably entwined with the function of the complex CPE assigned to AT&T. Conversely, complex intrasystem wiring has little or no relationship to the exchange functions assigned to the BOCs. The complex intrasystem wiring in Account 232 is only found *beyond* the PBX or key system unit, which is itself CPE to be transferred to AT&T; complex intrasystem wiring is in no way an extension of the local exchange outside the customer's premises.

In addition, the retention of intrasystem wiring by the BOCs presents significant potential operational problems. According to testimony filed by Pacific Telephone in its current rate case before CPUC,[17] installation and maintenance, sales, engineering, and other support personnel who are now assigned to install and service complex CPE, including intrasystem wiring, will accompany such equipment when it is transferred to AT&T. Such personnel will also be performing installation and maintenance for AT&T's new complex CPE systems, including intrasystem wiring. If intrasystem wiring is not transferred to AT&T at the same time as the associated complex apparatus and the personnel who install and maintain it, the BOCs will either have to contract with AT&T to have installation and maintenance performed on existing intrasystem wiring or will have to set up a new business installation and maintenance force to work on such equipment.

Moreover, it appears that AT&T, contrary to the terms of the decree (MFJ, §I(A)(2), at 174-175), has selectively retained all facilities and personnel relating to the provision of CPE but not all the associated investments on the books of account.

Complex on-premises telecommunications systems are a package; one company should own, offer for sale, install and recover rates for that package, and that is

[17] Testimony of R.J. Calloway before CPUC, filed July 5, 1983 in A.83-01-022, at 51, a document of public record judicially noticeable by this Court.

precisely what the decree intended.[18] AT&T's POR,

[18] AT&T's apparent answer to appellants' claim is a bald effort to rewrite the MFJ. First, AT&T contends that the definition of CPE intended by the decree is not that actually contained in the decree but that employed in *Second Computer Inquiry*, 84 F.C.C.2d at 61 n.10, 88 F.C.C.2d at 513 n.1, which excludes complex intrasystem wiring from the term "CPE." AT&T fails to cite any authority for this contention and is unable to explain why neither the language of *Second Computer Inquiry* nor a reference to that decision appears in the definition of CPE contained in the decree.

Moreover, the FCC in its current phase of the *Second Computer Inquiry* has taken the view that intrasystem wiring is an integral part of complex CPE and therefore should be transferred to AT&T and deregulated at the same time and in the same manner as the CPE which it joins. AT&T has told the FCC that it would be illegal to order this type of transfer because the MFJ herein has assigned complex intrasystem wiring to the BOCs. AT&T apparently desires to use the FCC proceeding to limit the definition of CPE in this divestiture case and then use this divestiture case to limit the FCC's ability to define the concept of CPE to include intrasystem wiring in the *Second Computer Inquiry*.

Second, AT&T argues that complex intrasystem wiring and related installation costs are not "equipment" within the meaning of the decree. This unsubstantiated assertion is refuted by the common dictionary definition of "equipment" (Reply Comments, CPUC, at 21) and by generally accepted accounting principles which include installation and connection costs as an integral part of the cost of a telecommunications system (*id.* at 21-22). Indeed, the notion that equipment costs include all expenditures incurred in acquiring the equipment and preparing it for use is forcefully confirmed by the decree's mandate that AT&T is to receive all "facilities . . . and books of account . . . *relating to . . . the provision of* customer premises equipment to the public."

Third, AT&T contends that the term "route" contained in the decree's definition of CPE refers solely to switching equipment and not to wire which carries a telecommunication toward its intended destination. Again, however, AT&T provides no authority for its assertion, nor does it offer any explanation as to why the term "switch," if truly intended, was not employed in the decree.

Finally, AT&T raises the "practical" claim that the varying elements of Account 232 cannot be separated out in a way which would meaningfully differentiate between the various assets it contains. This assertion is incorrect, as is demonstrated in Section IIA, *supra*. Even if the assertion were correct, which it is not, a credible argument could be made that all of Account 232 (or at least the subclass "Station Connections—Inside Wiring"), being an investment related to the provision of CPE, should be assigned to AT&T.

however, has retained what it deems the favorable CPE assets and has left to the BOCs what it deems the unfavorable assets, such as the complex intrasystem wiring investment reflected in Account 232. Appellants' sole remaining remedy for such manipulation of the decree is this appeal.

III. Cost of Debt

Section VIII(H) of the MFJ provides in part:

> [T]he quality of debt [of the separated BOCs] shall be representative of the average terms and conditions of the consolidated debt held by AT&T, its affiliates and the BOCs at that time.

(App. at 184-185).

The POR, consistent with the foregoing directive, states that "[t]he debt remaining with the BOCs upon divestiture will be representative of the average terms and conditions of debt throughout the Bell System." (POR, §I(B)(4), at 193-194.) Nevertheless, the POR goes on to ignore the most significant "term" or "condition" of a debt instrument—the rate of interest that it bears—and proposes a distribution of long-term funded debt which would leave Pacific with a significantly higher average cost of debt than any of the other regional BOCs and the Bell System as a whole. (*Id.*, at 194-195.) AT&T's stated rationale for its proposal, that "[a]ny attempt to equalize the costs among regions and companies would introduce a number of subsidies between and among the divested BOCs" (*id.*, at 195), makes no sense. Section VIII(H) of the decree was intended to protect the BOCs from AT&T's leaving them with debt obtained at unfavorable terms and conditions while assigning to itself debt carrying more advantageous terms. (App. at 135-137.) AT&T's

assumption of such higher-cost debt as will leave Pacific with an average cost of debt reasonably comparable to that of the other six BOCs and the Bell System as a whole will in no way affect the other BOCs; it will merely affect AT&T. (Prelim. Comments, CPUC, at 24-25; Further Comments, CPUC, at 47-48; Reply Comments, CPUC, at 9-13.)

AT&T claims that different treatment is warranted for Pacific than for the other BOCs because Pacific holds a less favorable financial position than the other BOCs due to actions of local regulators, such as appellant CPUC. (AT&T Response, at 285-298.) This claim is wholly lacking in merit. First, it is factually misleading: Pacific's present disadvantaged financial position is plainly due most directly to AT&T's historic failure to invest any equity in Pacific during the years 1973 to 1981. (Prelim. Comments, CPUC, at 15-23.) Second, the decree itself already accords Pacific different treatment than the other BOCs, if any such different treatment is warranted, by authorizing AT&T to leave Pacific with a higher debt ratio (50%) than the other BOCs (45%). (MFJ, §VIII(H); App. at 184.) Accordingly, AT&T's justification for unilaterally rewriting the MFJ's "terms and conditions" provision in its POR has already been addressed by a separate provision of the MFJ. (*See* App. at 136-137 and 137 n.320.) Third, since the Bell System, prior to divestiture, is essentially a single entity, it is the system as a whole that must bear the cost of its pre-divestiture debt portfolio, the parts of which were obtained at different times and places and on different terms and conditions. Notably, in approving the POR's allocation of contingent antitrust liabilities, the District Court *accepted* this very reasoning. (App. at 214-219.)

In view of the foregoing and the virtual concession by the Department of Justice that the POR violates the decree (DOJ Response, at 117-122),[19] the District Court's footnote disposition of appellants' claim is difficult to comprehend (App. at 221-222 n.64).

The decree established a fair balance to which the POR was supposed to adhere; no legitimate basis for a variance was offered; and appellants presented the District Court with a simple and straightforward approach which would have effectuated the decree's requirements. (*See* Prelim. Comments, CPUC, at 28-30; Reply Comments, CPUC, at 11-13.)[20] Nevertheless, the District Court's ruling ratifies what is effectively a unilateral appropriation by AT&T of assets which the decree rightfully bestows upon Pacific.

Absent action by this Court, the ultimate losers will be the citizens and ratepayers of the Pacific region.

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[19] The Department of Justice twice asked the District Court to grant a formal exception to the decree as described in §VIII(H) thereof (DOJ Response, at 118, 122), but the District Court never did so (App. at 221-222 n.64).

[20] Appellants submit the following example of how the inequity may easily be corrected: Under Amendment No. 36 to the POR, AT&T has agreed to assume five long-term debt issues of Pacific's, bringing Pacific's average cost of debt to approximately 9.5 percent. One of those issues bears a maturity date of 2015, a face amount of $300 million and a coupon rate of 8.875 percent. However, if AT&T were instead to assume two separate outstanding $150 million issues—one bearing a maturity date of 2020 and a coupon rate of 15 percent and the other bearing a maturity date of 2021 and a coupon rate of 16.125 percent—Pacific's cost of debt would markedly improve.

While the implementation of this suggestion would still leave Pacific with an average cost of debt of 9.2 percent—substantially greater than the average cost of debt of any of the other BOCs or the Bell System as a whole—it would certainly bring the plan closer to compliance with the MFJ. It is estimated that this adjustment would reduce Pacific's annual long-term cost of debt by more than $20 million, without necessitating any subsidy from the other BOCs.

IV. Plenary Review is Essential

The District Court's order of August 5, 1983, approving the details of the largest corporate reorganization in history, raises subtle, complex and difficult questions of compliance with the decree previously affirmed by this Court as well as broader questions concerning the adequacy of the District Court's protection of the public interest.

The only check on the District Court's ruling is the availability of careful review of the merits of appellants' claims by at least one appellate tribunal. While this Court's exercise of jurisdiction under 15 U.S.C. §29(b) would undoubtedly expedite the resolution of any uncertainties generated by the pendency of this appeal (*see generally* DOJ Motion for Certification, AT&T Response in Support), appellants neither sought nor participated in the District Court's certification decision because they considered the need for detailed review of their claims, whether by this Court or by the Court of Appeals, paramount. In a case as important as this one, considerations of expediency should not outweigh appellants' right to assert fully their public interest claims on appeal. Accordingly, should the Court for any reason determine not to accord appellant's claims plenary consideration, its fairest course would be to *deny* the direct appeal under 15 U.S.C. §29(b) and to remand the appeal to the United States Court of Appeals for the District of Columbia Circuit for decision only after full briefing and oral argument on the merits.

Conclusion

For the foregoing reasons, the Court should note probable jurisdiction.

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Respectfully submitted,

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